



Legislative Fiscal Bureau

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February 7, 2019

TO: Representative John Nygren
Room 308 East, State Capitol

FROM: Rick Olin and John Gentry

SUBJECT: Assembly Substitute Amendment 1 to Assembly Bill 4

At your request, this memorandum provides a description of Assembly Substitute Amendment 1 (ASA 1) to Assembly Bill 4 (AB 4). ASA 1 was introduced on February 5, 2019.

The substitute amendment would create a nonrefundable individual income tax credit, modify the manufacturing and agriculture tax credit, and sunset the working families tax credit beginning in tax year 2019, and modify the earned income tax credit beginning in tax year 2020.

10% Tax Credit

The substitute amendment would create a nonrefundable individual income tax credit based on each filer's net tax liability, subject to phaseout based on the claimant's Wisconsin adjusted gross income (WAGI), beginning in tax year 2019. For claimants whose WAGI is below an income threshold, the credit would equal the greater of 10% of the claimant's net income tax liability or \$100 (\$50 if married and filing separate). For claimants whose WAGI is above the income threshold, the credit would be based on the claimant's net tax liability. The percentage used in the credit calculation would decrease from 10% as WAGI increases, and would equal 0% when WAGI reaches a second income threshold. Filers whose WAGI exceeds the second income threshold would not be eligible for the credit. The phaseout thresholds would vary by filing type:

Filing Status

Income Thresholds for Credit Phaseout

Single or Head-of-Household
Married Joint
Married Separate

\$80,000 to \$100,000
\$125,000 to \$150,000
\$62,500 to \$75,000

Net tax liability would be based on the claimant's gross individual income tax less all nonrefundable tax credits. Part-year residents, nonresidents, and individuals filing as single

dependents would not be eligible for the credit. The Department of Revenue (DOR) would administer the credit under statutory provisions governing its administration of the individual income tax.

The credit would reduce individual income tax collections by an estimated \$411.8 million in tax year 2019, \$414.6 million in tax year 2020, and \$414.5 million in tax year 2021. These amounts translate into revenue decreases of \$424.2 million in 2019-20 and \$414.6 million in 2020-21, or \$838.8 million in the 2019-21 biennium. An estimated 1.9 million taxpayers would receive an average credit of just under \$220 annually.

Earned Income Tax Credit

The Wisconsin earned income tax credit (EITC) is a refundable individual income tax credit available to individuals who claim the federal earned income tax credit. Because the credit is refundable, the state budget system treats it as an expenditure. The state credit is calculated as a percentage of the federal credit, and the state percentages vary based on the number of the claimant's children. The substitute amendment would increase the state percentages for claimants with one child and with two children beginning in tax year 2020, as follows:

| <u>Number of Children</u> | <u>State Credit Percentages</u> | |
|-------------------------------|---------------------------------|-----------------|
| | <u>Current Law</u> | <u>Proposed</u> |
| One | 4% | 11% |
| Two | 11 | 14 |
| More than Two | 34 | 34 |

Under current law, an estimated 243,800 claimants will receive credits totaling \$100.4 million, and the average credit will equal \$412, in tax year 2020. However, the average credit for claimants with more than two children (\$1,350) is considerably higher than the average credit for claimants with two children (\$381) or claimants with one child (\$86). Under ASA 1, credits would increase by 27% for claimants with two children and 175% for claimants with one child. Average credits would increase to \$485 for two-children claimants and to \$237 for one-child claimants. An estimated 198,000 claimants would receive higher credits for tax year 2020. ASA 1 would increase GPR expenditures by an estimated \$26.7 million in 2020-21.

Working Families Tax Credit

The proposal would sunset the working families tax credit after tax year 2018. Under the credit, taxpayers with WAGI below \$9,000 (\$18,000 if married joint) may claim a credit equal to their net tax liability. The credit phases out over the next \$1,000 in income until eliminated when WAGI exceeds \$10,000 (\$19,000 if married joint). In tax year 2019, about 300 filers are expected to receive credits, in aggregate, an estimated \$100,000 under current law. Because there would be an interactive effect between the sunset of the working families credit and the proposed 10% tax credit, the effect of the working families tax credit sunset is reflected under the proposed 10% tax credit.

Manufacturing and Agriculture Credit

For corporate filers, the manufacturing and agriculture tax credit (MAC) is equal to 7.5% multiplied by the lesser of a claimant's: (a) eligible qualified production activities income (QPAI), as defined under the Internal Revenue Code (IRC), derived from manufacturing or agricultural property in Wisconsin; (b) income apportioned to Wisconsin for state corporate income/franchise tax purposes; or (c) income determined as taxable under state combined reporting provisions. For business owners who file under the individual income tax, the credit is equal to 7.5% of the claimant's eligible QPAI, as defined under the IRC, that is derived from manufacturing or agricultural property in Wisconsin. The amount of QPAI that may be used to calculate the MAC for individual filers is reduced by the amount of QPAI used to calculate the credit for taxes paid to another state. In addition, the credit may not be used by individual filers to offset taxes on other sources of income. Partnerships, limited liability companies, and tax-option corporations may not claim the MAC. Instead, the partners, members, and shareholders may claim the credit in proportion to their ownership interests.

The current tax credit percentage of 7.5% took effect in tax year 2016 and was phased in over a four-year period beginning in tax year 2013. If the amount of MAC claimed exceeds a claimant's tax liability, the claimant can carry the unused amount forward for use in a future tax year for up to 15 years. It is estimated that the MAC will reduce state tax revenues by \$291.4 million in 2018-19, \$308.3 million in 2019-20, and \$328.8 million in 2020-21.

ASA 1 would, for taxable years beginning after December 31, 2018, limit the amount of QPAI from manufacturing activities an individual or corporate filer may use as the basis of computing the MAC to no more than \$300,000 (which would provide for a maximum credit claim of \$22,500 per filer). This limit would not apply to income derived from agricultural activities.

Similarly, for taxable years beginning after December 31, 2018, the ASA 1 would limit the partners of a partnership, the shareholders of a tax-option corporation, and the members of a limited liability company to claiming the MAC based on income from manufacturing in an aggregate amount of no more than \$22,500. This limit would not apply to income derived from agricultural activities.

DOR estimates that the limit on MAC claims under ASA 1 would increase state tax revenues by \$55.3 million in 2018-19, \$224.6 million in 2019-20, and \$237.4 million in 2020-21. These amounts are comprised of: (a) individual income tax revenue, which is estimated to increase by \$42.9 million in 2018-19, \$174.3 million in 2019-20, and \$184.5 million in 2020-21; and (b) corporate income/franchise tax revenue, which is estimated to increase by \$12.4 million in 2018-19, \$50.3 million in 2019-20, and \$52.9 million in 2020-21. Because individual filers are only required to make estimated payments equal to the individual's tax liability for the preceding year, a portion of the estimated fiscal effect for 2018-19 may be delayed to 2019-20.

Fiscal Effect

ASA 1 would reduce the amount of resources in the state's general fund that are available for allocation in the 2019-21 biennium by \$348.2 million. This includes a net reduction in individual income and corporate income/franchise taxes of \$321.5 million and an increase in GPR expenditures of \$26.7 million. Combining the amounts from the preceding descriptions, the following table displays the estimated change by component:

Estimated Effect of ASA 1 to AB 4 on the General Fund in 2018-19 and the 2019-21 Biennium (Millions)

| | <u>2018-19</u> | <u>2019-20</u> | <u>2020-21</u> | <u>Total</u> |
|------------------------|----------------|----------------|----------------|---------------|
| GPR Taxes | | | | |
| Limit MAC | \$55.3 | \$224.6 | \$237.4 | \$517.3 |
| 10% Tax Credit | <u>0.0</u> | <u>-424.2</u> | <u>-414.6</u> | <u>-838.8</u> |
| GPR Tax Total | \$55.3 | -\$199.6 | -\$177.2 | -\$321.5 |
| GPR -- EITC | <u>0.0</u> | <u>0.0</u> | <u>26.7</u> | <u>26.7</u> |
| Effect on General Fund | \$55.3 | -\$199.6 | -\$203.9 | -\$348.2 |

Information on the distribution of individual income taxpayers with a tax change in tax year 2020 is included as an attachment to this memorandum. The attachment does not include corporate filers.

RO/JG/lb
Attachment

ATTACHMENT

Distribution of Individual Income Taxpayers with an Income Tax Decrease or Increase Under ASA 1 to AB 4, Tax Year 2020

| Wisconsin Adjusted Gross Income | Taxpayers with a Tax Decrease | | | | Taxpayers with a Tax Increase | | | |
|---------------------------------|-------------------------------|------------------------|----------------------|-------------------------------|-------------------------------|------------------------|----------------------|-------------------------------|
| | Percent of | | Count of All Returns | % of All Returns in AGI Class | Percent of | | Count of All Returns | % of All Returns in AGI Class |
| | Count | Amount of Tax Decrease | | | Count | Amount of Tax Increase | | |
| Under \$5,000 | 25,393 | -\$1,502,008 | 1.29% | 0.34% | 110 | \$4,408 | 1.83% | 454,630 |
| 5,000 to 10,000 | 22,475 | -2,511,276 | 1.15 | 0.57 | 107 | 4,638 | 1.78 | 208,370 |
| 10,000 to 15,000 | 76,048 | -7,544,178 | 3.88 | 1.71 | 48 | 4,814 | 0.80 | 176,110 |
| 15,000 to 20,000 | 109,041 | -12,953,361 | 5.56 | 2.94 | 45 | 7,374 | 0.75 | 160,480 |
| 20,000 to 25,000 | 134,212 | -17,192,767 | 6.84 | 3.90 | 50 | 10,023 | 0.83 | 160,860 |
| 25,000 to 30,000 | 141,069 | -17,560,879 | 7.19 | 3.98 | 34 | 9,930 | 0.56 | 161,060 |
| 30,000 to 40,000 | 296,730 | -37,668,459 | 15.12 | 8.54 | 51 | 14,498 | 0.85 | 306,000 |
| 40,000 to 50,000 | 249,555 | -40,221,708 | 12.72 | 9.12 | 82 | 30,449 | 1.36 | 254,940 |
| 50,000 to 60,000 | 193,564 | -41,038,777 | 9.87 | 9.30 | 73 | 30,761 | 1.21 | 203,440 |
| 60,000 to 70,000 | 156,013 | -41,809,667 | 7.95 | 9.48 | 66 | 34,732 | 1.10 | 161,960 |
| 70,000 to 80,000 | 122,358 | -39,677,417 | 6.24 | 8.99 | 67 | 34,729 | 1.11 | 128,620 |
| 80,000 to 90,000 | 104,523 | -36,750,605 | 5.33 | 8.33 | 34 | 17,627 | 0.56 | 107,540 |
| 90,000 to 100,000 | 90,481 | -32,066,585 | 4.61 | 7.27 | 46 | 38,450 | 0.76 | 93,950 |
| 100,000 to 125,000 | 143,301 | -77,429,857 | 7.30 | 17.55 | 208 | 238,997 | 3.45 | 181,200 |
| 125,000 to 150,000 | 97,159 | -35,239,200 | 4.95 | 7.99 | 175 | 201,263 | 2.90 | 118,290 |
| 150,000 to 200,000 | --- | --- | --- | --- | 510 | 614,676 | 8.46 | 116,520 |
| 200,000 to 250,000 | --- | --- | --- | --- | 402 | 697,389 | 6.67 | 50,210 |
| 250,000 to 300,000 | --- | --- | --- | --- | 360 | 810,383 | 5.97 | 24,840 |
| 300,000 to 500,000 | --- | --- | --- | --- | 856 | 2,805,263 | 14.21 | 35,020 |
| 500,000 to 1,000,000 | --- | --- | --- | --- | 1,089 | 10,059,106 | 18.07 | 17,400 |
| 1,000,000 and over | --- | --- | --- | --- | 1,613 | 166,431,183 | 26.77 | 8,060 |
| Total | 1,961,922 | -\$441,166,745 | 100.00% | 100.00% | 6,026 | \$182,100,693 | 100.00% | 3,129,500 |

| Wisconsin Adjusted Gross Income | Taxpayers with a Tax Change | | | | Taxpayers with a Tax Increase | | | |
|---------------------------------|-----------------------------|----------------------|----------------------|-------------------------------|-------------------------------|------------------------|----------------------|-------------------------------|
| | Percent of | | Count of All Returns | % of All Returns in AGI Class | Percent of | | Count of All Returns | % of All Returns in AGI Class |
| | Count | Amount of Tax Change | | | Count | Amount of Tax Increase | | |
| Under \$5,000 | 25,503 | -\$1,497,600 | 1.30% | 0.58% | 110 | \$4,408 | 1.83% | 454,630 |
| 5,000 to 10,000 | 22,582 | -2,506,638 | 1.15 | 0.97 | 107 | 4,638 | 1.78 | 208,370 |
| 10,000 to 15,000 | 76,096 | -7,539,364 | 3.87 | 2.91 | 48 | 4,814 | 0.80 | 176,110 |
| 15,000 to 20,000 | 109,086 | -12,945,988 | 5.54 | 5.00 | 45 | 7,374 | 0.75 | 160,480 |
| 20,000 to 25,000 | 134,262 | -17,182,744 | 6.82 | 6.63 | 50 | 10,023 | 0.83 | 160,860 |
| 25,000 to 30,000 | 141,103 | -17,550,949 | 7.17 | 6.77 | 34 | 9,930 | 0.56 | 161,060 |
| 30,000 to 40,000 | 296,781 | -37,653,961 | 15.08 | 14.53 | 51 | 14,498 | 0.85 | 306,000 |
| 40,000 to 50,000 | 249,637 | -40,191,258 | 12.69 | 15.51 | 82 | 30,449 | 1.36 | 254,940 |
| 50,000 to 60,000 | 193,637 | -41,008,016 | 9.84 | 15.83 | 73 | 30,761 | 1.21 | 203,440 |
| 60,000 to 70,000 | 156,079 | -41,774,935 | 7.93 | 16.13 | 66 | 34,732 | 1.10 | 161,960 |
| 70,000 to 80,000 | 122,425 | -39,642,688 | 6.22 | 15.30 | 67 | 34,729 | 1.11 | 128,620 |
| 80,000 to 90,000 | 104,557 | -36,732,978 | 5.31 | 14.18 | 34 | 17,627 | 0.56 | 107,540 |
| 90,000 to 100,000 | 90,527 | -32,028,135 | 4.60 | 14.38 | 46 | 38,450 | 0.76 | 93,950 |
| 100,000 to 125,000 | 143,509 | -77,190,861 | 7.29 | 29.80 | 208 | 238,997 | 3.45 | 181,200 |
| 125,000 to 150,000 | 97,334 | -35,037,937 | 4.95 | 13.52 | 175 | 201,263 | 2.90 | 118,290 |
| 150,000 to 200,000 | 510 | 614,676 | 0.03 | -0.24 | 510 | 614,676 | 8.46 | 116,520 |
| 200,000 to 250,000 | 402 | 697,389 | 0.02 | -0.27 | 402 | 697,389 | 6.67 | 50,210 |
| 250,000 to 300,000 | 360 | 810,383 | 0.02 | -0.31 | 360 | 810,383 | 5.97 | 24,840 |
| 300,000 to 500,000 | 856 | 2,805,263 | 0.04 | -1.08 | 856 | 2,805,263 | 14.21 | 35,020 |
| 500,000 to 1,000,000 | 1,089 | 10,059,106 | 0.06 | -3.88 | 1,089 | 10,059,106 | 18.07 | 17,400 |
| 1,000,000 and over | 1,613 | 166,431,183 | 0.08 | -64.24 | 1,613 | 166,431,183 | 26.77 | 8,060 |
| Total | 1,967,948 | -\$259,066,052 | 100.00% | 100.00% | 6,026 | \$182,100,693 | 100.00% | 3,129,500 |

- An estimated 1,967,948, or 62.88%, of all taxpayers in 2020 would experience a tax change, with 1,961,922, or 62.69%, experiencing a tax decrease, and 6,026, or 0.19%, experiencing a tax increase.
- The total tax change is estimated at -\$259.1 million, with tax decreases of \$441.2 million exceeding tax increases of \$182.1 million.
- Among taxpayers with a tax decrease, the average decrease would be \$225 and be targeted to filers with WAGI below \$150,000. In general, the average decrease would grow as WAGI increases until WAGI exceeds \$125,000.
- Among taxpayers with a tax increase, the average increase would be \$30,219, but that average is heavily influenced by taxpayers with WAGI of \$1 million or more, whose average increase is \$103,181.
- Taxfilers without a tax change would include taxfilers without a tax liability, those unable to claim the proposed 10% credit, and those unaffected by the proposed income limitation under the MAC.
- The table does not include the effect on manufacturers that pay corporate income/franchise taxes and claim the MAC.
- Data in some cells is suppressed or rounded to protect taxpayer confidentiality.

Source: Department of Revenue simulation of tax year 2020.

